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RUEHNE/AMEMBASSY NEW DELHI PRIORITY 1708
RUEHPB/AMEMBASSY PORT MORESBY PRIORITY 3743
RUEHUL/AMEMBASSY SEOUL PRIORITY 4498
RUEHKO/AMEMBASSY TOKYO PRIORITY 1752
RUEHWL/AMEMBASSY WELLINGTON PRIORITY 2488
RUEHHK/AMCONSUL HONG KONG 2546
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RHEFDIA/DIA WASHINGTON DC
RHEHNSC/NSC WASHDC
RHHJJPI/USPACOM HONOLULU HI
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C O N F I D E N T I A L SECTION 01 OF 04 JAKARTA 000684

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E.O. 12958: DECL: 04/04/2018
TAGS: [PGOV](#) [EFIN](#) [ECON](#) [KDEM](#) [ID](#)
SUBJECT: PRESIDENT YUDHOYONO IN POLITICAL TROUBLE DUE TO
HIGH COMMODITY PRICES

REF: A. JAKARTA 633
[1](#)B. JAKARTA 579
[1](#)C. JAKARTA 286
[1](#)D. JAKARTA 204

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Classified By: Ambassador Cameron R. Hume, reasons 1.4(b+d).

[1](#)1. (C) SUMMARY: High commodity prices and economic pressures on the poor could jeopardize President Yudhoyono's quest for a second term. Considered a virtual lock for re-election as recently as a few months ago, SBY's re-election bid may now hinge less on his ability to defeat an undistinguished field of competitors than on his skill navigating the growing popular backlash against high oil and food prices. Upcoming gubernatorial elections in Java could help gauge the explosiveness of the issue.

[1](#)2. (C) SUMMARY (Con'd): In an effort to preserve his lead in the polls, SBY has directed his administration to maintain generous subsidies meant to alleviate economic pressure on poor households. However, with higher commodity prices driving the cost of these subsidies to more than a quarter of the budget, this short-term remedy carries with it the potential to undermine Indonesia's long-term economic prospects. In the meantime, with the political season beginning in earnest, long-term reform measures are stalled

with little prospect of moving forward soon. END SUMMARY.

NO LONGER UNASSAILABLE

13. (C) Until very recently, most observers viewed the President as all but unassailable. After all, even the latest available polling data suggests that President Yudhoyono still retains an advantage over the likely field of competitors for the 2009 race, with only former president Megawati currently registering double digits in the polls. The inevitability air surrounding President Yudhoyono's candidacy has disappeared, however, in the face of increasing evidence that rising food costs and attendant economic problems have the potential to exact a high political cost.

14. (C) Overall food prices in Indonesia have increased by 12 percent in just one year, with prices for staple commodities like flour and cooking oil both nearly doubling. These increases have disproportionately impacted the poor and lower middle class, key constituencies in Indonesia, and there is ample anecdotal evidence that some of SBY's supporters are becoming disillusioned with his inability to deliver on his poverty reduction program. SBY's rivals clearly smell blood and have honed in on the poverty issue, with one political rival--General (ret'd) Wiranto--loudly claiming that the poverty rate has reached 60 percent. In fact, while Indonesia's official poverty rate is actually 16.6 percent (income less than \$1.55 a day), the World Bank estimates an additional 32.4 percent of the population--over 75 million people--are near poor (income \$1.55-\$2 a day).

15. (C) Such distinctions are lost on the average Indonesian, however. The poor and near poor spend over one half of their income on food, and they are painfully aware that they can buy less food for their family today than possible a year

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ago. Conversations with dozens of ordinary people and grassroots organizations clearly signal that large numbers of poor Indonesians believe that they are living on the brink of economic survival. Labor leaders have reported that the working man does not factor democracy and basic rights into his political thinking but rather just how he will pay the bills. Regular protests against rising prices and media coverage of how rising prices are hurting people contribute to this perception. The feeling among many working class Indonesians is that their economic security was more stable under Suharto, regardless of whether that is true. Another indication of the fragile household economy are the millions of Indonesians migrating overseas annually, many knowing how vulnerable they will be but left with no other choice.

WEST JAVA - THE POTENTIAL CANARY IN THE COAL MINE

16. (C) The April 13 election in West Java province could well serve as a useful barometer of the political explosiveness of the issue of rising prices (Ref A). West Java's size (it is Indonesia's largest province with over 40 million people), recent history of mirroring national results on the local level, and commercial strength all point to its potential to serve as a bellwether. Nationally, in 2004, President Yudhoyono captured 61 percent of the vote there, compared with former President Megawati's 39 percent; West Java was an almost perfect microcosm of the national results, with 62.5 percent support for SBY, and 37.5 percent for Megawati. The incumbent Governor, Danny Setiawan, has received SBY's endorsement but is battling back a well-funded challenger (an ally of former president Megawati's) who has turned the commodity price issue into his rallying cry.

17. (C) Numerous political commentators who are watching the race closely have confirmed that the commodity price issue could decide the outcome. Many believe a loss for Setiawan could serve as a harbinger of things to come for SBY next year. Elections later this year in the equally large and important provinces of Central Java (June 22) and East Java

(July 23) could also help gauge the political explosiveness of this issue.

SBY STAYING THE COURSE

18. (C) According to Presidential Special Advisor T.B. Silalahi, President Yudhoyono--while well aware of the explosiveness of the poverty issue--was nevertheless supremely confident that he would win re-election. Silalahi said that Yudhoyono did not believe that Megawati, Wiranto, ex-Jakarta Governor Sutiyoso, or any of the other potential presidential candidates represented a significant threat.

19. (C) Silalahi reported that in light of the lack of credible challengers, the president had concluded that he could afford to tread political water for one more year and avoid making any potentially risky policy maneuvers on the reform side. According to Silalahi, SBY realized that he would not be able to lower poverty in any appreciable way in the one year remaining before the election anyway. The strategy for re-election was simple, preserve the lead and run out the clock.

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BAND AID MEASURES

10. (C) President Yudhoyono has publicly acknowledged that oil and food prices will remain high and maintained that Indonesia must adapt. He has also worked hard to appear responsive to the impact economic forces are having on the poor. In a March 26 speech to the Indonesian Employers' Association, SBY outlined an economic growth strategy that he called "pro-growth, pro-job, and pro-poor." In response to higher food prices, SBY has also introduced a host of remedial measures, including a reduction of import tariffs and value added taxes, an increase in export taxes, and new price subsidies aimed at easing the impact of higher prices on the poor (Ref D).

11. (C) Slow implementation and unabated increases in global food prices have rendered most of the administration's policies ineffective, however. For example, the repeal of a required instant noodle vitamin supplement--which provides 16 percent of the average Indonesian's iron intake--only saves producers 0.27 cents per kilo. Even the removal of a 10 percent value added tax on wheat and a 10 percent tariff on soybeans provides very limited price relief relative to the rise in the global price of those commodities--90 percent and 40 percent, respectively--over the past year. Most analysts expect the GOI to continue to focus on short-term poverty alleviation programs such as increased price subsidies and straight cash transfers to the poor.

SUBSIDY PAYMENTS: THE \$25-30 BILLION LOST OPPORTUNITY

12. (SBU) GOI subsidies have softened the blow of higher oil prices, but the cost of this policy is high. Fuel is now 40 percent below market price. The oil subsidy largely benefits the rich as the richest 10 percent of the population receives over 40 percent of the fuel subsidy benefit, according to the World Bank. Oil and electricity subsidies in GOI budget estimates are Rp 187 trillion (\$21 billion), 4.5 percent of GDP. The IMF estimates the oil and electricity subsidy bill to be Rp 217 trillion (\$24 billion), or 5.0 percent of GDP. Combined with food subsidies (Rp 47 trillion, \$5 billion), the subsidy bill totals \$25-30 billion, or 25-30 percent of the budget.

13. (C) Subsidies exceed development spending, estimated at Rp 164 trillion (\$18 billion), or 3.8 percent of GDP. The GOI has already ordered a 15 percent cut to all ministry budgets, including defense. A senior advisor to the Finance Minister told us that the government may actually need to cut ministry budgets by as much as 30 percent this year to pay for the rising subsidy bill, a rate that will reduce

significantly basic government services.

ADDITIONAL THREATS

¶14. (C) A significant jump in poverty or macroeconomic instability could force the government to raise interest rates and cut spending on key services, a distinct possibility in the absence of a sound policy response. Such a scenario would likely create a popular backlash against the

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GOI and, by extension, imperil SBY's re-election prospects. And higher interest rates would create a drag on economic growth and, if they result in a higher exchange rate, undercut Indonesia's international competitiveness. In short, if the policy focus remains locked on the short-term--which most analysts expect to be the case--the winner of the presidential election will likely confront an economic landscape with deteriorating government finances, inflation, slower growth, massive infrastructure investment needs, high unemployment levels, and an increased incidence of poverty.

A GLOOMY OUTLOOK

¶15. (C) Based on our soundings, rising commodity prices and a protracted global economic slowdown could jeopardize President Yudhoyono's re-election bid. The Yudhoyono administration's track record of strong growth and macroeconomic stability has not translated into new jobs or a meaningful reduction in poverty and SBY's base is feeling the pinch. Despite the ominous signs of economic unease, the paucity of credible presidential challengers seems to have lulled SBY into a potentially false sense of political security. Rather than craft a coherent strategy to address pressures on government finances and poor households, President Yudhoyono has relied exclusively on short-term policy tools to show activism and stop the bleeding. Not only could this myopic approach potentially backfire and cost him the election, but even if he does win, he may find that he has secured a second term by signing a Faustian pact that harms the country's mid-to long-term economic prospects.
HUME